Postal Regulatory Commission
Submitted 1/23/2017 2:36:51 PM
Filing ID: 98745
Accepted 1/23/2017

BEFORE THE

POSTAL REGULATORY COMMISSION

Institutional Cost Contribution Requirement for Competitive Products	))	Docket No. RM2017-1

**COMMENTS OF
PARCEL SHIPPERS ASSOCIATION,
ALLIANCE OF NONPROFIT MAILERS,
AMERICAN CATALOG MAILERS ASSOCIATION,
CONTINUITY SHIPPERS ASSOCIATION,
DATA & MARKETING ASSOCIATION,
ENVELOPE MANUFACTURERS ASSOCIATION,
NATIONAL ASSOCIATION OF PRESORT MAILERS,
NATIONAL NEWSPAPER ASSOCIATION,
PSI SYSTEMS, AND STAMPS.COM
("MARKET DOMINANT MAILERS AND
COMPETITIVE SHIPPERS")**
(January 23, 2017)

The Market Dominant Mailers and Competitive Shippers (MDMCS) file these comments pursuant to Order No. 3624, the advance notice of proposed rulemaking issued by the Commission on November 22, 2016. Some of us represent mailers that rely mainly on market dominant products. Others represent shippers that mainly use competitive Postal Service products. Still others represent substantial users of both kinds of Postal Service products. All of us urge the Commission to eliminate the minimum contribution requirement.

This requirement is unnecessary to promote a level playing field between the Postal Service and its competitors, prohibit cross subsidization, or ensure that competitive products pay an appropriate share of the Postal Service's institutional costs. Indeed, the requirement is now an irrelevant anachronism: the contribution to institutional costs earned by the Postal Service from competitive products has far outstripped the 5.5 percent minimum established in 2007. Moreover, increasing the minimum contribution requirement enough to influence competitive product prices could harm the Postal Service, its customers, and American consumers. Even leaving the required minimum contribution in place at its current level would be a needless invitation to mischief.

In Docket Nos. RM2007-1 and RM2012-3, the Commission found no evidence that the Postal Service enjoyed an unfair competitive advantage over private carriers. Order No. 26 (August 15, 2007) at 73; Order No. 1449 (August 23, 2012) at 24. The Postal Service's pricing decisions since 2007 and 2012 should alleviate any residual concern that the Postal Service has an incentive to compete unfairly by holding its prices down. The Postal Service clearly has no such incentive. It raised competitive products prices by an average of 9.5 percent last January and another 3.9 percent yesterday. USPS FY 2016 10-K at 15, 31.

Over the past decade, the Postal Service has raised competitive product prices much faster than inflation, substantially increasing the cost coverage and institutional cost contribution of competitive products. Competitive products are projected to contribute nearly $7 billion[1] to Postal Service institutional costs in FY 2017, an amount representing more than 20 percent of total Postal Service institutional costs and nearly four times the 5.5 percent of institutional costs currently required.

Furthermore, while the minimum contribution requirement has been largely irrelevant and thus unnecessary to this point, setting it too high (even if below current contribution levels) "could hinder the Postal Service's flexibility to compete" effectively. Order No. 1449 at 12. This would harm the Postal Service, its customers, and American consumers, particularly those not well served by private carriers.

1. The Postal Service Is Not Subsidizing Competitive Products and Has Not Priced Competitive Products to Give Itself an Unfair Competitive Advantage

In Docket No. RM2007-1, the Commission found that the Postal Service had incentives to exceed the minimum contribution requirement, which was only a regulatory floor:

[1] The source of this figure and all other figures in this document is library reference MDMCS-RM2017-1/1.

> Appropriate share is a floor for all competitive products, but the hope (and expectation) is that competitive products will generate contributions in excess of the floor. Thus, it is unlike reasonably assignable in two other respects: it applies to competitive products collectively, not to subclasses or services individually; and it represents a minimum (not maximum) contribution level, serving as a threshold for compliance with section 3633(a)(3). Because it may retain earnings, the Postal Service has incentives to exceed this threshold, including reducing rate pressure on market dominant rates, continuation of universal service, and the possibility of bonuses.

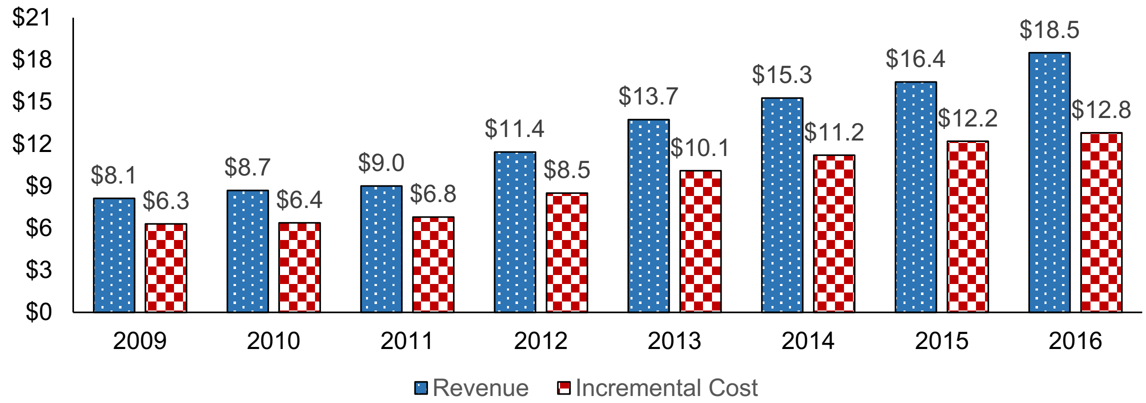
Order No. 26 August 15, 2007) at 72.

Ten years of experience have proven the Commission right. The Postal Service has not cross-subsidized competitive products or held competitive product prices down in a manner suggesting it seeks an unfair advantage. Rather, it has increased competitive product prices rapidly, substantially increasing the contribution of competitive products to institutional costs.

a. The Postal Service Is Not Subsidizing Competitive Products.

The minimum contribution requirement in law, 39 U.S.C. 3633(a)(3), does not prohibit cross subsidization. Other provisions govern that. *See,* 39 U.S.C. 3633(a)(1) and (2). As the Commission has recognized, the appropriate test for cross subsidization is the incremental cost test. Order No. 3506 in Docket No. RM2016-2 (Sept. 9, 2016); Order No. 3641 in Docket No. RM2016-13; 39 C.F.R. § 3015.7. A product or group of products is not subsidized if its revenues exceed its incremental costs. As Figure 1 shows, competitive product revenues have consistently exceeded incremental costs. Furthermore, the excess of revenues over incremental costs tripled from $1.8 billion in FY 2009 to $5.7 billion in FY 2016.

Figure 1: Competitive Product Revenue and Incremental Cost (in Billions)



b. The Postal Service Has Increased Competitive Product Prices Substantially Over the Past Decade.

The Postal Service has increased competitive product prices since 2007 at rates substantially exceeding inflation. This is true for both products that were on the initial list of competitive products codified by Congress at 39 U.S.C. 3621(a) and 3631(a) in December 2006 (Figure 2, below) and products that the Commission later transferred from the market-dominant list to the competitive list under 39 U.S.C. 3642 (Figure 3). This aggressive pricing regime has reduced, not increased, the likelihood that the Postal Service is operating at an unfair competitive advantage.

Figure 2: Parcel Select, Priority Mail Express, and Priority Mail Rate Increases v. CPI-U, 2007-2017

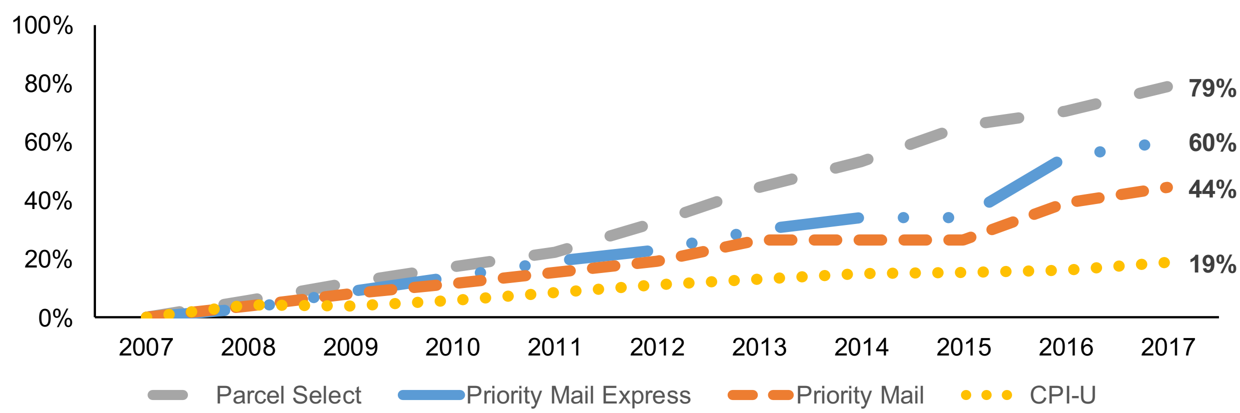
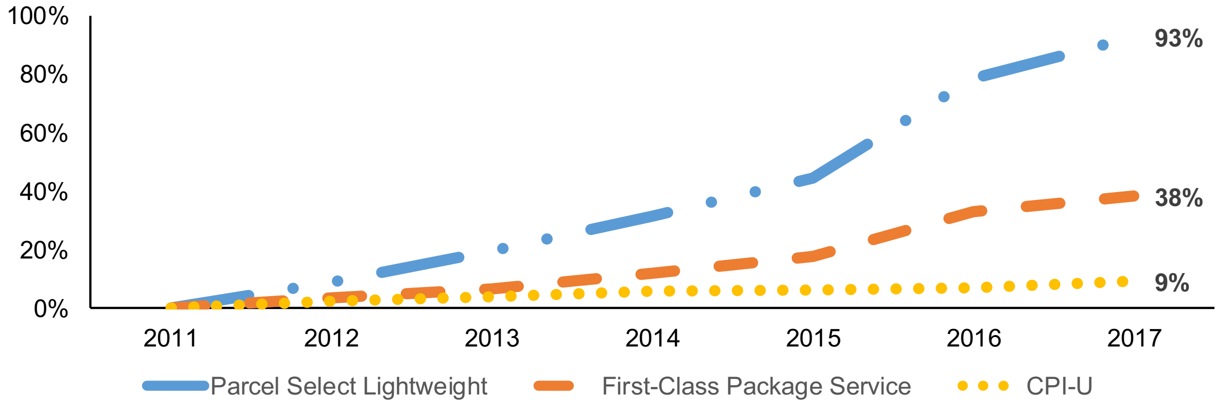


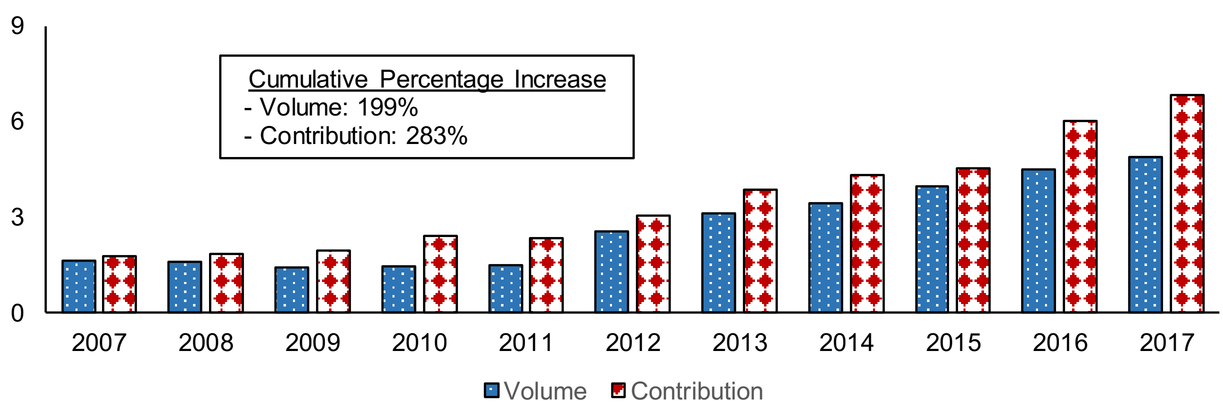
Figure 3: Parcel Select Lightweight and First-Class Package Service Rate Increases v. CPI-U, 2011-2017



c. Competitive Product Price Increases Since 2007 Have Resulted in Contribution Increasing Faster Than Competitive Product Volume.

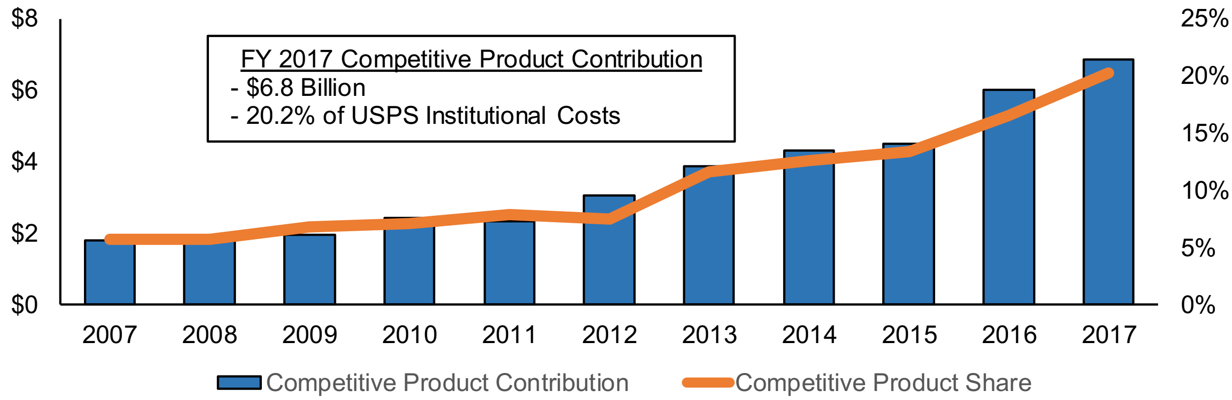
One reason for the increase in the contribution from competitive products over the past decade has been the surge in competitive product volume resulting from the e-commerce boom and the transfer to the competitive product list of products now known as Parcel Select Lightweight and First-Class Package Services. These volume changes, however, explain only part of the substantial increase in the contribution from competitive products. As Figure 4 shows, the growth in contribution from competitive products has substantially outpaced the growth in competitive product volume, the difference resulting largely from competitive product price increases.

Figure 4: Competitive Product Mail Volume and Contribution (in Billions)



As Figure 5 shows, the contribution from competitive products was $6 billion in FY 2016 and is projected to increase to nearly $7 billion in FY 2017, almost four times the 5.5% appropriate share threshold.

Figure 5: Competitive Product Contribution (Billions) and Institutional Cost Share



This contribution is critical to the Postal Service and its customers. To ensure its financial health, the Postal Service has every incentive to make pricing decisions in pursuit of competitive product contribution. To put the contribution from competitive products into perspective, an annual contribution of $7 billion amounts to approximately 13 percent of total market dominant product revenue.[2] That is, ignoring price-driven volume effects, market dominant prices would need to be 13 percent higher to make up for the loss of this contribution. Just as shippers of packages benefit from the Postal Service's success in letter and flat mail delivery, mailers of letters and flats benefit from the growth of the Postal Service's business in package delivery.

2. Setting the Minimum Contribution Requirement Too High Would Hurt the Postal Service, Its Customers, and End Consumers.

Raising the minimum contribution requirement to a level that affects prices is not just unnecessary, it could be harmful. As the Commission has noted, "setting the contribution level too high could adversely affect the Postal Service ability to compete."

[2] FY 2016 market-dominant revenue was $52.9 billion. FY 2016 Revenue, Pieces, and Weight Report.

Order No. 1108 (January 6, 2012) at 2. The losers would include the Postal Service's customers, ultimate consumers, and the Postal Service itself.

A regulatory constraint that forced the Postal Service to raise its package delivery prices would directly harm both parcel shippers and ultimate consumers through higher prices and shipping costs.[3] The harm from artificially inflated prices would spread nationwide, but rural and residential consumers would suffer most because private carriers often impose hefty surcharges for delivery to rural ZIP Codes and residential addresses.

Additionally, regulator-driven price increases would cause the Postal Service to lose profitable volume to private competitors. The resulting loss of contribution would harm not only the Postal Service, but also its remaining customers. Users of Postal Service products not subject to the CPI price cap would face higher prices. All Postal Service customers would ultimately be hurt as the Postal Service's declining finances lead to slower, more limited and less reliable service.

Finally, keeping the required minimum contribution comfortably below current levels is not without risk. Market conditions – such as the state of the economy, pricing strategies of private carriers, and customer needs (e.g., volumes, service requirements, package characteristics) – change, often without warning and with a potential effect on the Postal Service's ability to generate contribution. Indeed, because private carriers are major users of Postal Service competitive products for last-mile delivery, these companies have the power to reduce the share of institutional costs paid for by competitive products. For strategic or operational reasons, a competitor could simply shift a portion of its package volumes from Postal Service delivery to its own delivery networks.

For the above reasons, the best course now is to eliminate the minimum contribution requirement.

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[3] Even customers of private carriers would be harmed because regulator-driven price increases imposed on the Postal Service may reduce competitive pressures on private carriers and allow them to raise their own prices.

Respectfully submitted,

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